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No. 92-641

IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

LEONARD NOBELMAN and HARRIET NOBELMAN,

Petitioners,

vs.

AMERICAN SAVINGS BANK,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR AMICUS CURIAE FEDERAL HOME LOAN MORTGAGE CORPORATION IN SUPPORT OF RESPONDENT

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BRIEF FOR AMICUS CURIAE FEDERAL HOME LOAN MORTGAGE CORPORATION IN SUPPORT OF RESPONDENT

QUESTION PRESENTED

Does Section 1322(b)(2) of the United States Bankruptcy Code, 11 U.S.C. §§ 101-1330 (the "Bankruptcy Code"), which provides special protection for residential mortgage lenders in cases under Chapter 13 of the Bankruptcy Code, prohibit a Chapter 13 debtor from modifying the rights of a creditor holding a claim secured only by a mortgage on debtor's principal residence by "cramming down" that creditor's secured claim to the value of the property under Section 506(a) of the

Bankruptcy Code, and then discharging the balance of the claim with unsecured debts under a Chapter 13 plan?[1]

STATEMENT OF INTEREST OF AMICUS CURIAE

Federal Home Loan Mortgage Corporation ("Freddie Mac") is a corporate instrumentality of the United States, chartered by Congress as part of its policy fostering home ownership. Its statutory mission is to foster and promote a secondary market for the purchase and sale of mortgages on residential property.[2]

Freddie Mac acts in the secondary mortgage market to increase the liquidity of mortgage investments and thereby make more capital available for home financing. Banks, savings associations and other lenders originate loans on the primary mortgage market, and then sell those loans on the secondary mortgage market to Freddie Mac. Freddie Mac, in turn, resells

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[1] "Cram-down is a term which refers to an attempt by a Chapter 13 debtor to reduce a secured claim to the value of the collateral securing the claim and to discharge the balance as an unsecured claim under the Chapter 13 plan." *Nobelman v. American Savings Bank (In re Nobelman)*, 968 F.2d 483, 486 n.5 (5th Cir. 1992).

The following example illustrates how cram-down works. Assume that a lender makes a loan in the amount of $150,000, which is secured by property having a value at the time the loan is made of $160,000. Assume the debtor files for bankruptcy protection two years after the loan is made. Assume further that during that two-year period the real estate market in the area where the property is located has declined and the value of the property has dropped to the point where at the time of the bankruptcy case, the value of the property is $100,000, although the amount owed to the creditor which is secured by the property is still $150,000. If the debtor is permitted to cram-down the creditor's claim, the creditor will be found to have a secured claim in the amount of $100,000. The balance of the claim, in the amount of $50,000, may be discharged with unsecured debts under the debtor's Chapter 13 plan, and the creditor is likely to receive little or no payment on that claim. If the value of the property subsequently appreciates above $100,000, debtor is permitted to retain this "windfall".

[2] Freddie Mac filed an amicus brief in support of Respondent with the United States Court of Appeals for the Fifth Circuit and an amicus brief in support of a petition for a writ of certiorari with this Court.

the mortgages to investors in the form of mortgage pass-through securities which represent interests in groups of mortgages. With the funds received from the resale of the mortgages, Freddie Mac purchases more mortgages from originating lenders who in turn make those funds available to home purchasers.

The secondary mortgage market thus greatly increases the supply, and reduces the cost, of home mortgage credit to America's homeowners. The smooth functioning of this market depends upon a predictable flow of principal and interest from home mortgages. Where cram-down is permitted, and borrowers are allowed unilaterally to reduce the balance of their mortgage loans, this predictability is undermined.

SUMMARY OF ARGUMENT

Chapter 13 offers a simplified and expedited means by which individual debtors having unsecured debt of less than $100,000 and secured debt of less than $350,000 can obtain adjustment of indebtedness under a Chapter 13 plan, which provides for limited payment to creditors over a period of five years or less. Section 1322 of the Bankruptcy Code sets forth the mandatory and permissive provisions of a Chapter 13 plan, and includes special protection for lenders holding a claim secured only by the debtor's principal residence. This special protection, contained in Section 1322(b)(2), provides, in relevant part, that a Chapter 13 plan may

> modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence, or of holders of unsecured claims.

11 U.S.C. § 1322(b)(2).

There is no dispute that Respondent is entitled to the protection of Section 1322(b)(2) because its claim is secured only by a security interest in debtor's principal residence. The issue before this Court, which has divided circuit courts, bankruptcy courts and district courts throughout the country, is the extent of such

protection. Petitioners assert that under Section 506(a) of the Bankruptcy Code they may modify Respondent's claim by reducing the amount of the secured claim to the value of the collateral and discharging the portion of the claim which exceeds such value with other unsecured claims.[3] Essentially, Petitioners want to limit the protection of Section 1322(b)(2) to the amount of the secured claim following cram-down under Section 506(a), leaving the unsecured portion of the claim free to be modified. This would leave the lender with a lien up to the value of the property and would discharge the lien on the unsecured portion of the lender's claim.[4]

Petitioners arrive at this result by suggesting that Section 1322(b)(2) must be read with an eye towards life in the real

[3] Section 506(a) provides that a claim secured by a lien on property is a secured claim to the extent of the value of the property securing it, and is an unsecured claim to the extent the claim exceeds such value.

[4] Regardless of whether the unsecured portion may be modified, courts universally agree that a Chapter 13 debtor may not alter the amount or the timing of the payments required to be made under the mortgage, or change the mortgage interest rate. Any other conclusion would render the protection of Section 1322(b)(2) completely meaningless. *See Bellamy v. Federal Home Loan Mortgage Corp.*, 962 F.2d 176, 184-85 (2d Cir. 1992). *See also In re Honett*, 116 B.R. 495, 497 (Bankr. E.D. Tex. 1990) (despite "the allowance of the bifurcation of a Chapter 13 creditor's secured claim . . . the interest rate or monthly payment amount cannot be modified"); *In re Hayes*, 111 B.R. 924, 926 (Bankr. D. Or. 1990) (the reduction of the monthly payment to reflect the lower balance to be paid after cram-down is an impermissible modification); *In re Hyden*, 110 B.R. 46, 50 (Bankr. W.D. Okla. 1990) ("Even when the claim is bifurcated under § 506(a) . . . the provisions of § 1322(b)(5) protect the creditor at least to the extent that they require that the default, i.e., the arrearages, be cured in a reasonable time and that regular payments be maintained, albeit for a shorter period of time."); *In re Demoff*, 109 B.R. 902, 920 (Bankr. N.D. Ind. 1989) ("The size and timing of the installment payments will not be altered and thus the scheduled amount of the monthly contract payment will remain the same, as will the interest rate."); *In re Ross*, 107 B.R. 759, 762 (Bankr. W.D. Okla. 1989) ("Thus, the amount of the payments required to be made under the governing documents may not be changed, although the result may be that the obligation secured by the mortgage may be paid in full much more rapidly."). Indeed, Petitioners acknowledge the prohibition on such modifications. *See* Petitioners' Brief at p. 7.

world of real estate and mortgage foreclosure. Yet it is they who ignore reality. Petitioners mistakenly believe that cram-down merely replicates a foreclosure sale at which "the lienholder will receive something approximating the fair market value [of the collateral], with the balance of its claim becoming an unsecured deficiency claim". *See* Petitioners' Brief at p. 6. In point of fact, rather than mirror foreclosure, cram-down destroys the essence of a mortgagee's rights in a foreclosure.

Faced with an undersecured loan, a mortgagee can credit-bid at the foreclosure sale and become the owner of the property.[5] The mortgagee then holds the hope that the real estate market will improve and at least some of its deficiency can be recovered. This is the real world of bank examiners and loan officers — deciding when to and when not to credit-bid *i.e.*, on which properties should they play the market hoping for a turnaround and on which should they simply take what they can get and write off the rest. In fact, typically the lender will credit-bid its claim and become the owner of the property. This is the real world that cram-down eliminates by taking away this option from the mortgagee.

Cram-down fails to replicate foreclosure in two other ways. First, in a cram-down, the mortgagee only has a lien up to the market value of the property and must pray that the debtor, who previously could not make monthly principal and interest payments, will now faithfully mail a check every month for the very amount he or she previously could not afford. Thus, in cram-down the mortgagee continues to bear the risk of a default under debtor's reorganization plan. If such default occurs, the mortgagee will incur, for a second time, the expense and delay of instituting another foreclosure action and possibly the expense and delay of a second bankruptcy proceeding. Indeed, multiple bankruptcy filings by the same debtor are quite common. By contrast, in foreclosure, if someone does buy the property for its market value, the mortgagee receives that amount in a

[5] Credit-bidding is the process by which the secured creditor can bid at the sale up to the full amount of its claim. *See* 11 U.S.C. § 363(k) (providing for the secured creditor to offset its claim against the purchase price of the property).

lump sum cash payment and has no further risk of a default by debtor.

Second, private mortgage insurance programs require a lender to foreclose before they will pay for the lender's loss. Insurance will not cover the lender's loss following cram-down, but will only guarantee payment of the reduced balance. Thus, in foreclosure insurance protects the difference between the debt and the value of the property; in cram-down it does not. Cram-down and foreclosure are worlds apart.

Petitioners go on to say that cram-down benefits the debtor by making refinancing a "viable option". *See* Petitioners' Brief at p. 8. To think that lenders will provide market rate financing to a person fresh out of bankruptcy for the full market value of the property (*i.e.* 100% loan-to-value) simply is to fantasize.

Petitioners jump from these false "practical aspects" to the conclusion that Section 1322(b)(2) must be read to permit cram-down based on the assumption that Section 506(a) of the Bankruptcy Code limits Section 1322's express protection. But that is the very question before this Court, not the answer. Even if Petitioners "practical aspects" were true, they would be largely irrelevant to what is a question of statutory interpretation. The question is whether the special statutory protection for residential mortgage lenders protects the mortgagee's entire claim or only the amount of such claim up to the value of the collateral. There can be only one answer: the statute expressly precludes modification of the rights of holders of a claim secured by residential property. The lender's entire claim is secured by the collateral and thus cram-down would modify the lender's rights impermissibly.

The United States Court of Appeals for the Fifth Circuit agreed, rejecting Petitioners' arguments, as well as the Circuit Court decisions supporting Petitioners. *See Bellamy v. Federal Home Loan Mortgage Corp. (In re Bellamy)*, 962 F.2d 176 (2d Cir. 1992); *Eastland Mortgage Co. v. Hart (In re Hart)*, 923 F.2d 1410 (10th Cir. 1991); *Wilson v. Commonwealth Mortgage Corp.*, 895 F.2d 123 (3d Cir. 1990); *Hougland v. Lomas & Nettleton Co. (In re Hougland)*, 886 F.2d 1182 (9th Cir. 1989). The Fifth Circuit recognized, as many bankruptcy courts and district courts have, that the express language and the legislative history of Section 1322(b)(2) mandate the conclusion that cram-down of a residential mortgage lender's claim violates the Bankruptcy Code. *See Nobelman*, 968 F.2d 483 (5th Cir. 1992).[6] Further support for the Fifth Circuit's decision can be found in this Court's recent decision in *Dewsnup v. Timm*, ____U.S.____, 112 S.Ct. 773 (1992), through an analysis of the untenable effects of permitting cram-down on the overall structure of Chapter 13 and the primary and secondary mortgage markets, and by consideration of Congressional policy favoring home ownership.

Thus, the conflict among the Circuit Courts of Appeals should be resolved by an affirmance of the Fifth Circuit's decision in *Nobelman*, making crystal clear that Chapter 13 debtors may not cram-down a residential mortgage lender's claim to the value of the collateral securing such claim. The special protection afforded residential mortgage lenders in Section 1322(b)(2) of the Bankruptcy Code requires that such mortgage debt be paid in full according to its original terms.

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[6] Lower court decisions which had previously reached the same conclusion as the Fifth Circuit in *Nobelman* include: *In re Russell*, 93 B.R. 703 (D.N.D. 1988); *In re Mitchell*, 125 B.R. 5 (Bankr. D.N.H. 1991); *In re Etchin*, 128 B.R. 662 (Bankr. W.D. Wis. 1991); *In re Wilks*, 123 B.R. 555 (Bankr. W.D. Tex. 1991); *In re Boullion*, 123 B.R. 549 (Bankr. W.D. Tex. 1990); *In re Chavez*, 117 B.R. 733 (Bankr. S.D. Fla. 1990); *In re Sauber*, 115 B.R. 197 (Bankr. D. Minn. 1990); *In re Schum*, 112 B.R. 159 (Bankr. N.D. Tex. 1990); *In re Kaczmarczyk*, 107 B.R. 200 (Bankr. D. Neb. 1989); and *In re Catlin*, 81 B.R. 522 (Bankr. D. Minn. 1987).

ARGUMENT

I

THE PLAIN MEANING OF SECTION 1322(b)(2) PRECLUDES A DEBTOR FROM CRAMMING DOWN A CLAIM SECURED ONLY BY THE DEBTOR'S PRINCIPAL RESIDENCE

"In determining the meaning of any statute, the words of the statute are 'the primary, and ordinarily the most reliable, source of interpreting' its meaning." *In re Chavez*, 117 B.R. 733, 735 (Bankr. S.D. Fla. 1990) (*quoting Watt v. Alaska*, 451 U.S. 259, 266 n.9 (1981)). *See United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 242 (1989) ("The plain meaning of legislation should be conclusive, except in 'rare cases [in which] the literal application of a statute will produce a result demonstrably at odds with the intention of its drafters.' ") (*quoting Griffin v. Ocean Contractors, Inc.*, 458 U.S. 564, 571 (1982)).

A. *The Express Language of Section 1322(b)(2) Protects From Modification the "Rights of Holders" of Secured Claims, Not Only the Secured Portion of the Creditor's Claim*

Section 1322(b)(2) permits a Chapter 13 plan to "modify the *rights* of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence." 11 U.S.C. § 1322(b)(2) (emphasis added). "Rights" is the object of "modify" in the phrase that precedes the critical exception to permissible modifications at issue in this case.

Indeed, the Fifth Circuit explicitly recognized the proper reading of Section 1322(b)(2) stating,

> section 1322(b)(2) describes its subject matter as the modification of "the *rights of holders* of" claims, not as the modification of *claims* as such; thus the section can be properly read as *excepting* from its reach

> modification of "*the rights of holders of* . . . a claim secured only by a security interest in real property that is the debtor's principal residence. . . ." Therefore, even if the entirety of such a claim is not a secured claim (as per Section 506(a)), the rights of a holder of such a claim may not be modified under section 1322(b)(2).

Nobelman, 968 F.2d at 488 (emphasis in original). *See also In re Lee*, 137 B.R. 285, 287 (Bankr. E.D. Wis. 1991) (under Section 1322(b)(2) "it is the 'rights of holders' and not the 'claims' alone which cannot be modified") (citation omitted); *In re Etchin*, 128 B.R. 662, 668 (Bankr. W.D. Wis. 1991) (Section 1322(b)(2) protects all of the various rights of undersecured mortgage holders, not just the secured portion of the claim).

Petitioners seek to avoid the plain meaning of Section 1322(b)(2) stating that by virtue of Section 506(a), the Bankruptcy Code has "reduced the rights of the holder" of a residential mortgage lien. *See* Petitioners' brief at pp. 11-12. By presuming that Section 506(a) limits the protections of Section 1322(b)(2) without examining the latter's express language, Petitioners simply beg the question of to what extent Section 1322(b)(2) protects a residential mortgage lender's claim.

Section 1322(b)(2) does not state, as Petitioners claim, that it is only a creditor's *secured claim* which may not be modified. Rather, by its express terms the statute provides that a residential mortgage holder's *rights* may not be modified by a Chapter 13 debtor. It necessarily follows that a Chapter 13 debtor may not cram-down such lender's claim to the value of the collateral, but must pay the entire indebtedness in accordance with its original terms. Anything less would be a modification of the rights of the residential mortgage holder in contravention of the express terms of Section 1322(b)(2) of the Bankruptcy Code.[7]

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[7] The Second Circuit missed the mark by stating that "[t]he real question is whether the 'rights' to which § 1322(b)(2) refers include the mortgagee's rights concerning its *claim* or its rights with respect to its *secured claim*."

(Footnote continued)

B. *The "Other-Than" Clause of Section 1322(b)(2) Expressly Precludes Cram-down of a Residential Mortgage Lender's Claim*

Assuming, *arguendo*, that Section 1322(b)(2) is *not* interpreted to prohibit modification of the *rights* of residential mortgage holders, but rather to address the modification of *claims* of residential mortgage holders, the same result must follow. This is so because the "other-than" clause of Section 1322(b)(2) demonstrates that a residential mortgage holder's claim is fully protected from modification.

Section 1322(b)(2) provides, in relevant part, that a Chapter 13 plan may

> modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence.

The plain and obvious meaning of the phrase, "other than a claim secured only by a security interest in real property that is the debtor's principal residence", is that a *claim* for which the only security held by the lender is a home mortgage cannot be modified. "Claim" is expressly defined in the Bankruptcy Code as *any* "right to payment, *whether or not such right is . . . secured or unsecured*." 11 U.S.C. § 101(5)(A) (emphasis added). Thus, it is apparent from the language of the statute that

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Bellamy, 962 F.2d at 179 (emphasis in original). Concluding that treatment under the Bankruptcy Code generally turns on whether a *claim* is secured or unsecured, rather than the status of the *creditor* as secured or unsecured, the Second Circuit concluded that the rights which cannot be modified are those of the secured claim, not the secured creditor. *Id.* at 179-181.

The critical flaw in this analysis is that the express language of Section 1322(b)(2) protects the "*rights of holders* of secured claims" and no basis exists for imposing a limit on this clear statutory provision. While other provisions of the Bankruptcy Code may focus on the status of a claim rather than the status of the creditor, Section 1322(b)(2) by its express terms is not so limited.

1322(b)(2) protects from modification both the secured *and* any unsecured portion of a residential mortgage holder's claim.[8]

Indeed, Section 506(a), the very provision which Petitioners rely on, distinguishes between a "claim secured" and a "secured claim". As one bankruptcy court recently stated,

> Section 506(a) declares that an "allowed claim of *a creditor secured by* a lien on property . . . is *a secured claim* to the extent of the value of such creditor's interest in the estate's interest in such property." *Thus, the "claim of a creditor secured by a lien on property" is not necessarily a "secured claim."* Whether it is or not will depend on the value of the creditor's interest in the estate's interest in the property. *But whether or not the claim is a "secured claim", it is still a "claim . . . secured by a lien on property."*

In re Strober, 136 B.R. 614, 620 (Bankr. E.D.N.Y. 1992) (*quoting* 11 U.S.C. § 506(a)) (emphasis added in part).

By limiting a residential mortgage lender's protection to the secured portion of its claim, the courts permitting cram-down impose a limitation on Section 1322(b)(2) in complete disregard of this critical difference between a "secured claim" and a "claim secured". Even if the mortgage exceeds the value of the property, the claim is still secured only by a residential mortgage despite the fact that only a portion of the claim is a "secured" claim as defined in Section 506(a). *See id.* at 619. *Cf. Dewsnup*, ____U.S.____, 112 S.Ct. at 781 (Scalia, J., *dissenting*) (majority held that for purposes of Section 506(d) the phrase "secured claim" simply constitutes a claim backed by a security interest in property regardless of whether the value of the property suffices to cover the claim).

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[8] The conclusion that the word "claim" in the "other-than" clause must be read to include any unsecured deficiency amount held by a residential mortgage lender is reinforced by the fact that the language preceding that clause refers to "secured claims," while the "other-than" clause simply refers to "a claim." This juxtaposition underscores the drafters' intent to maintain the independence of the "other-than" clause from the preceding "secured claims" language. *See In re Etchin*, 128 B.R. at 667-68.

Thus, the restriction on modification provided for in the "other-than" clause of Section 1322(b)(2) is not limited to the portion of the creditor's claim which is secured, but extends to the entire claim, secured or unsecured, provided that the security consists only of an interest in debtor's principal residence. Accordingly, the Fifth Circuit's decision must be affirmed.[9]

C. *The Specific Provision of Section 1322(b)(2) Must Override the General Provision of Section 506(a) if they Conflict*

When correctly interpreted in the manner outlined above, Section 1322(b)(2) is not inconsistent with Section 506(a). Section 506(a) does not purport to determine a creditor's right to receive payment of its claim or the extent to which a creditor's rights may be modified under a plan. *See Bellamy*, 962 F.2d at 180; *In re Simpkins*, 16 B.R. 956, 965 (Bankr. E.D. Tenn. 1982). These matters are specifically provided for elsewhere in the Bankruptcy Code, and specifically in Section 1322(b)(2) for Chapter 13.

Even if Sections 1322(b)(2) and 506(a) were found by this Court to be in conflict, it is a basic tenet of statutory construction that "[g]eneral language of a statutory provision, although broad enough to include it, will not be held to apply to a matter specifically dealt with in another part of the same enactment." *D. Ginsberg & Sons v. Popkin*, 285 U.S. 204, 208 (1932) (citation omitted); *see Gozlon-Peretz v. United States*, 498 U.S. 395, 111 S.Ct. 840, 848 (1991). *See also Nobelman*, 968 F.2d at 488 ("[w]e accordingly hold that the specific language of section 1322(b)(2) prevails over the general language of section 506(a)").

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[9] The Second Circuit rejected this argument out of hand, stating that under the "rule of the last antecedent" the other-than clause should be read to refer to the words immediately preceding it—"secured claims". *Bellamy*, 962 F.2d at 180-81. *See also Lomas Mortgage v. Wiese*, 980 F.2d 1279 (9th Cir. 1992). This simply ignores the full "other-than" clause with its reference to a "claim" and the all-encompassing definition of the word "claim" that is applicable throughout the Bankruptcy Code, including in Chapter 13. 11 U.S.C. § 101(5)(A); *see Etchin*, 128 B.R. at 668.

In sum, the only interpretation of Section 1322(b)(2) which is grammatically comprehensible and consistent with the other provisions of the Bankruptcy Code is that Chapter 13 debtors are precluded from cramming down residential mortgage debt. Thus, the decision of the Fifth Circuit was correct and should be affirmed by this Court.

II

THE LEGISLATIVE HISTORY OF SECTION 1322(b)(2) CONFIRMS THAT CRAM-DOWN OF RESIDENTIAL MORTGAGE DEBT IS PROHIBITED

The Fifth Circuit's interpretation of Section 1322(b)(2) which protects the right of a residential mortgage lender to full payment in accordance with the original terms of its mortgage and note also is supported by the legislative history of the statute. This is as apparent from the evolution of Section 1322(b)(2) as from its language.

Under Chapter XIII of the Bankruptcy Act of 1898, the statutory predecessor of Chapter 13, an individual's reorganization plan could not modify the rights of *any* creditor holding a claim secured by real property. As first proposed, the House version of the Bankruptcy Code completely eliminated this rule, setting no limits on the ability of an individual to modify secured claims through a Chapter 13 plan. *See* H.R. 8200, 95th Cong., 1st Sess. Sec. 1322(b)(2) (1977). The Senate version, on the other hand, preserved the protection afforded under Chapter XIII to all creditors secured by real estate. *See* S. 2266, 95th Cong., 1st Sess. Sec. 1322(b)(2) (1977).

At Senate hearings in the 95th Congress, the concerns of residential mortgage lenders about the impact of the House version were voiced by Edward J. Kulik, Senior Vice President, Real Estate Division, Massachusetts Mutual Life Insurance Co.

> When a plan is "crammed-down" . . . the secured creditor is paid only the depressed "appraised value" of the property—even though it is substantially less

> than the principal balance of the debt – the secured creditor loses any possibility of recovering the full debt if the real estate market returns to more normal conditions. Hence, the creditor is, in substantial part, denied its security and its contract rights.

Hearings Before the Subcommittee on Improvements of the Judicial Machinery of the Committee on the Judiciary, United States Senate, 95th Cong., 1st Sess. (1977), p. 709.

Mr. Kulik emphasized that allowing cram-down of residential mortgage debt to occur would have a particularly severe adverse effect on the availability of home mortgage funding. As Mr. Kulik explained allowing cram-down "may cause residential mortgage lenders to be extraordinarily conservative in making loans in cases where the general financial resources of the individual borrower are not particularly strong." *Id.* at p. 714. To avoid this result, he proposed that the legislation be modified to protect the right to payment of the *entire amount* secured by a residential mortgage, stating

> [s]erious consideration should be given to modifying both bills so that, at the least: *one, a mortgage on real property other than investment property may not be modified.*

Id. (emphasis added).

It is against this background that Section 1322(b)(2)'s compromise language, limiting the broad anti-modification protection of the former Bankruptcy Act to holders of claims secured by residential mortgages, must be read. Indeed, the legislative history of Section 1322(b)(2) was carefully analyzed by the United States Court of Appeals for the Fifth Circuit which concluded that the compromise language was intended to protect residential mortgage lenders from modification, including cram-down.

> With regard to § 1322(b)(2), the Senate receded from its position that no 'modification' was to be permitted

> of *any* mortgage secured by real estate; it instead agreed to a provision that modification was to be barred *only* as to a claim 'secured only by a security interest in real property *that is the debtor's principal residence.*' This limited bar was apparently in response to perceptions, or to suggestions advanced in the legislative hearings, *see* note 13 *supra* [citing Mr. Kulik's testimony] that home-mortgagor [sic] lenders, performing a valuable social service through their loans, needed special protection against modification thereof (*i.e.*, reducing installment payments, *secured valuations*, etc.).

Grubbs v. Houston First American Savings Association, 730 F.2d 236, 246 (5th Cir. 1984) (emphasis added in part).

It is apparent from the legislative history that the intent of Section 1322(b)(2) is to preserve the availability of residential mortgage funding for individuals of modest means by prohibiting Chapter 13 debtors from cramming down the claims of residential mortgage lenders. This is precisely the modification of rights that residential real estate lenders expressed concern about in hearings held shortly before the final enactment of the Bankruptcy Code, and precisely the modification that Section 1322(b)(2) prohibits. *See Nobelman*, 968 F.2d at 489 (the legislative history envisions an intent not to permit any modification on a claim secured by the debtor's principal residence and thus Section 506(a) cannot be used to bifurcate the claim and vitiate the protection of Section 1322(b)(2)).[9]

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[9] To the limited extent that the Third Circuit analyzed the legislative history of Section 1322(b)(2), it focused on the report of the Commission on Bankruptcy Laws of the United States, which was issued at the beginning of the legislative process, years prior to the final enactment. *Wilson*, 895 F.2d at 127-28. The Second, Ninth and Tenth Circuits concluded that, while the legislative history evidences an intent to protect home mortgage lenders, it does not reveal the extent of this protection and thus the legislative history is not inconsistent with the conclusion that only the secured portion of the creditor's claim cannot

(Footnote continued)

III

THIS COURT'S DECISION IN *DEWSNUP V. TIMM* SUPPORTS THE FIFTH CIRCUIT'S INTERPRETATION OF SECTION 1322(b)(2) OF THE BANKRUPTCY CODE

In *Dewsnup v. Timm*, ____U.S.____, 112 S.Ct. 773 (1992), this Court held that a Chapter 7 debtor may not cram-down a creditor's lien on real property to the value of the collateral when that value is less than the amount of the claim secured by the lien and avoid the lien with respect to the amount exceeding the value of the collateral. While this decision was rendered in the context of Chapter 7, "it is almost impossible to reconcile the decision's rationale with any different result in Chapter 13." *In re Strober*, 136 B.R. at 615-16.

In *Dewsnup*, debtor asserted that under Section 506(d) of the Bankruptcy Code the creditor only retains a lien up to the value of the property securing the debt and the lien for the amount above the value of the property is void.[11] Recognizing the ambiguous nature of the term "secured claim" in Section 506(d), this Court rejected debtor's argument, focusing on the pragmatic impact of debtor's position.

> The practical effect of petitioner's argument is to freeze the creditor's secured interest at the judicially determined valuation. By this approach, the creditor would lose the benefit of any increase in the value of the property by the time of the foreclosure sale. The increase would accrue to the benefit of the debtor, a result some the parties describe as a "windfall."

be modified. *Bellamy*, 962 F.2d at 182; *Hart*, 923 F.2d at 1415; *Hougland*, 886 F.2d at 1185. These courts overlooked the testimony before the Senate quoted above which highlighted the importance of preventing cram-down of residential mortgage lenders in Chapter 13. This testimony leads to the conclusion, which was reached by the Fifth Circuit, that protection of the residential mortgage lender's entire claim is mandated by Section 1322(b)(2).

[11] Section 506(d) states, in relevant part, "[t]o the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void."

> We think, however, that the creditor's lien stays with the real property until the foreclosure. That is what was bargained for by the mortgagor and the mortgagee. . . .Any increase over the judicially determined valuation during bankruptcy rightly accrues to the benefit of the creditor, not to the benefit of the debtor and not to the benefit of other unsecured creditors whose claims have been allowed and who had nothing to do with the mortgagor-mortgagee bargain.

Dewsnup, ____U.S.____, 112 S.Ct. at 778.

The same analysis and conclusion apply here. Allowing cram-down of residential mortgage debt in Chapter 13 cases will yield the precise result this Court condemned in *Dewsnup* — a windfall to the debtor which properly should flow to the mortgage lender in the amount of any increase in the value of the property. *See* Section IV(A) *infra*. Further, even less authority exists for permitting bifurcation and cram-down in this case than existed in *Dewsnup* because Chapter 13 contains an explicit prohibition against modification of " 'a claim secured only by a security interest in real property that is the debtor's principal residence'. " *Strober*, 136 B.R. at 619 (*quoting*, 11 U.S.C. § 1322 (b)(2)). It simply defies logic to permit a Chapter 13 debtor to bifurcate and cram-down a residential mortgage holder's claim while a Chapter 7 debtor has no such right.[12]

Indeed, since the *Dewsnup* decision, the Fifth Circuit as well as some bankruptcy courts have concluded that *Dewsnup* provides further support for the conclusion that Chapter 13 debtors may not cram-down the claim of a residential mortgage lender. *See Nobelman*, 968 F.2d at 487 ("The Supreme Court's recent decision in *Dewsnup* lends support to this view that bifurcation is impermissible.") (citation omitted); *Strober*, 136 B.R.

[12] Nor could a Chapter 11 debtor cram-down a mortgage as Petitioners seek to do in Chapter 13. Under Section 1111(b) of the Bankruptcy Code, a secured creditor may elect to have the lien securing its claim secure the entire amount of the claim. By making this so-called 1111(b) election, the creditor receives the benefit of appreciation in the collateral up to the full amount of its claim secured by the collateral.

at 618 (decisions allowing cram-down of a residential mortgage holder's claim in Chapter 13 cases have been "weakened, if not demolished, by *Dewsnup*"); *In re Barnes*, 146 B.R. 854, 855 (Bankr. W.D. Okla. 1992) (based upon *Dewsnup* decision, adopting *Nobelman* analysis despite Tenth Circuit decision in *Hart*); *In re Doss*, 143 B.R. 952, 953-54 (Bankr. E.D. Okla. 1992) (rejecting bifurcation based upon express language of Section 1322(b)(2) as well as this Court's decision in *Dewsnup*); *In re Davidoff*, 136 B.R. 567, 569 (Bankr. M.D. Fla. 1992) (*Dewsnup* supports conclusion that bifurcation of a residential mortgage lender's claim is not permitted under Section 1322(b)(2)).[13]

[13] The Second Circuit concluded that *Dewsnup* was inapposite because its analysis was limited to Section 506(d) and did not extend to Chapter 13. *Bellamy*, 962 F.2d at 182-84. The *Dewsnup* decision post-dated the briefing and oral argument in *Bellamy*, and the Second Circuit denied Freddie Mac's petition for rehearing and rehearing *en banc*. Therefore Freddie Mac was not provided an opportunity to argue the impact of *Dewsnup* on Chapter 13.

The Third and Ninth Circuits have reaffirmed their cram-down decisions following *Dewsnup* based upon the lead of the Second Circuit. *See Lomas Mortgage v. Wiese*, 980 F.2d 1279, 1282 (9th Cir. 1992) (summarily dismissing impact of *Dewsnup* based on *Bellamy*, stating "[n]owhere does *Dewsnup* suggest that its discussion of 'lien stripping' has any impact on the bifurcation of secured claims from unsecured claims for purposes of Chapter 13"); *Sapos v. Provident Institution of Savings*, 967 F.2d 918, 921 (3d Cir. 1992) (relying on *Bellamy*, the court concluded that "the holding of *Dewsnup* is limited to chapter 7 liquidations only and does not reach reorganization under chapter 13").

These decisions fail to recognize the unjustifiable windfall to the debtor which was the impetus for this Court's decision in *Dewsnup* and which similarly flows from allowing cram-down in Chapter 13. *See* Argument IV(A), *infra*.

IV

CRAM-DOWN OF RESIDENTIAL MORTGAGE DEBT IS AT ODDS WITH THE STATUTORY SCHEME OF CHAPTER 13 AND IS UNFAIR AND UNWORKABLE

While the express language of Section 1322(b)(2) and its legislative history clearly demonstrate that the Fifth Circuit's decision was correct, this Court's holistic approach to statutory construction outlined in *United Savings Association of Texas v. Timbers of Inwood Forest Associates, Ltd.*, 484 U.S. 365 (1988) provides further support for the conclusion that a residential mortgage lender's entire claim is protected from modification.

> Statutory construction, however, is a holistic endeavor. A provision that may seem ambiguous in isolation is often clarified by the remainder of the statutory scheme – because the same terminology is used elsewhere in a context that makes its meaning clear. . . or because only one of the permissible meanings produces a substantive effect that is compatible with the rest of the law.

Id. at 371 (citation omitted).

The meaning of Section 1322(b)(2) is indeed clarified when it is viewed in the context of the statutory scheme of Chapter 13. This is so for precisely the reason stated by this Court in *Timbers* – because only the interpretation of Section 1322(b)(2) to forbid cram-down of residential real estate mortgages "produces a substantive effect that is compatible with the rest of the law". *Id.* (citation omitted). This can be seen from the fact that the interpretation of Section 1322(b)(2) urged by Petitioners produces a number of results which are inconsistent – indeed, at odds with – the statutory scheme. Consideration of these results also highlights the deficiencies of the decisions of the Second, Third, Ninth and Tenth Circuits allowing cram-down.[14]

[14] The Third, Ninth and Tenth Circuits did not address the untenable effects of cram-down on the structure of Chapter 13, the primary and secondary

(Footnote continued)

A. *Cram-down Provides a Windfall to Chapter 13 Debtors*

Cram-down of residential mortgage debt in Chapter 13 cases provides a windfall to Chapter 13 debtors in times of instability in real estate markets because it allows them to reduce their mortgage debt to the temporarily depressed market value of the property and then to reap the benefit of the appreciation in the value of the property when the market recovers. This is precisely the windfall that this Court condemned in *Dewsnup*, and which, under that decision, cannot occur in a case under Chapter 7 of the Bankruptcy Code.[15]

Nor could such a windfall occur if the property were sold, either in the bankruptcy case or outside bankruptcy, or if the property were treated under a Chapter 11 plan. If the property were sold at a bankruptcy or foreclosure sale, the creditor would have the right to acquire the property by credit-bidding its claim, and then to realize the benefit of future appreciation by holding the property and selling it when the market recovers.[16]

Similarly, under a Chapter 11 plan, a secured creditor may elect under Section 1111(b) of the Bankruptcy Code to have the lien securing its claim secure the entire amount of its claim. By so electing, the creditor may receive the benefit of appreciation in the value of the collateral up to the full amount of its claim,

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mortgage markets or Congressional policy favoring home ownership. The Second Circuit summarily dismissed these practical implications with little analysis, stating, "[o]nce it is understood that the 'rights' which § 1322(b)(2) protects are limited to the secured claim (as per § 506(a)), Federal Home and amici's alternative arguments can be readily resolved." *Bellamy*, 962 F.2d at 184.

[15] Petitioners acknowledge that cram-down may indeed result in such windfall for debtors. *See* Petitioners' Brief at pp. 8-9.

[16] Thus Petitioners' assertion that cram-down has the same effect on the residential mortgage lender (Petitioners' Brief at p. 6) simply ignores this right to credit-bid which is eliminated if cram-down is permitted. *See* p. 5 *supra*.

even if the collateral is worth less than the amount of the claim at the time the plan is confirmed.

B. *Cram-down Would Result in Home Mortgage Lenders Receiving Worse Treatment Under Chapter 13 Than Other Secured Creditors*

Cram-down of residential mortgage debt would also create the paradoxical result, surely at odds with the undeniable intent of Section 1322(b)(2) to protect residential mortgage lenders, of subjecting them to worse treatment than other secured creditors in times of rising interest rates. This is so because under Section 1325(a)(5)(B)(ii), a creditor receiving payment over time of a secured claim under a Chapter 13 plan is entitled to receive interest at a market rate which compensates the creditor for not receiving payment of the full amount of its secured claim upon confirmation of the Chapter 13 plan.

But Section 1322(b)(2), by prohibiting modification of the rights of a creditor whose claim is secured by a lien on the debtor's principal residence, would restrict a residential mortgage lender to the contract rate even if it is less than the market rate. *See In re Terry*, 780 F.2d 894 (11th Cir. 1985); *In re Brown*, 91 B.R. 19 (Bankr. E.D. Va. 1988); *In re Simpkins*, 16 B.R. 956 (Bankr. E.D. Tenn. 1982). *See also* n.4 *supra*. Thus, when the residential mortgage lender's claim is crammed down to the value of the collateral, and a below-market contract interest rate is applied to this reduced claim, the result is that the residential mortgage lender receives significantly less favorable treatment than a secured creditor who is *not* entitled to the special protection of Section 1322(b)(2).

An example will help illustrate the point. A 30-year $200,000 mortgage at an interest rate of 6% requires monthly payments of $1,199.11. If the value of the property drops to $100,000 but interest rates rise to 15%, the mortgagor may file for bankruptcy under Chapter 13, and if Petitioners' view were adopted, seek to cram-down the mortgagee's lien to $100,000, but continue the $1,199.11 monthly payment and 6% interest rate. It would

then take 108 payments to satisfy the "new" $100,000 debt in full. However, the present value of 108 payments of $1,199.11 with interest rates at 15% is only $70,814, not $100,000. Thus, the residential mortgage lender does not receive the present value of its claim while any other creditor would under Section 1325. Surely this absurd result flies in the face of the meaning of the statute and the undisputed intent of Congress to benefit and protect residential mortgage lenders.[17]

C. *Instead of Assisting Chapter 13 Debtors, Cram-down Would Result in Their Being Required to Pay the Entire Amount of the Secured Claim in Five Years or Less Under Section 1322(c)*

The incorrectness of Petitioners' interpretation of Section 1322(b)(2) is further underscored by the fact that if they were permitted to cram-down their home mortgage lenders, they would be required to pay the entire amount of the secured claim – *i.e.*, the value of the collateral – in five years or less pursuant to Section 1322(c) of the Bankruptcy Code, which states that

[17] Allowing cram-down of residential mortgage claims without providing the lender with payment of the present value of the collateral may result in an unconstitutional "taking" of the creditor's property without just compensation. *See Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555 (1935) (bankruptcy statute violated Takings Clause because debtor could purchase property for less than fair market value and present value of the payments to the creditor was below value of the property). Indeed, this Court relied on *Radford* in reaching its decision in *Dewsnup*. *See Dewsnup*, ____U.S.____, 112 S.Ct. at 779.

Thus, to avoid a potential constitutional infirmity Petitioners' interpretation of Section 1322(b)(2) must be rejected under the "cardinal principal that [the Supreme Court] will first ascertain whether a construction of the statute is fairly possible by which the constitutional question may be avoided." *United States v. Security Industrial Bank*, 459 U.S. 70, 78 (1982) (citation and quotation omitted). *See also Edward J. DeBartolo Corp. v. Florida Gulf Coast Building & Construction Trades Council*, 485 U.S. 568, 575 (1988) (it is a well-settled axiom of statutory interpretation that "where an otherwise acceptable construction of a statute would raise serious constitutional problems, the [Supreme] Court will construe the statute to avoid such problems unless such construction is plainly contrary to the intent of Congress.") (citations omitted).

> [t]he plan may not provide for payments over a period that is longer than three years, unless the court, for cause, approves a longer period, but the court may not approve a period that is longer than five years.

11 U.S.C. § 1322(c).

Where cram-down is available (*i.e.*, where the creditor's claim is *not* secured only by the debtor's principal residence and is therefore not entitled to Section 1322(b)(2) protection), Section 1322 gives the debtor two choices in the treatment of secured claims. The debtor may cure any default and reinstate the obligation pursuant to Section 1322(b)(5), paying it in accordance with its original terms. Alternatively, the debtor may elect to cram-down the secured obligation thereby reducing it to the value of the underlying collateral. If this latter option is chosen, however, payment of the entire amount of the secured claim must be made under the plan within the five year period.

The Fourth Circuit explained the debtor's alternatives in *Landmark Financial Services v. Hall*, 918 F.2d 1150 (4th Cir. 1990).

> To summarize, the principal components of a § 1325 cram-down are retention of the lien by the secured creditor and provision for the payment, during the life of the plan, i.e. 3-5 years, of the full value of the secured claim.... A cure essentially involves (1) satisfying any arrearages currently due, within a reasonable time, and (2) maintaining regular mortgage payments as they come due.... Whereas the cram-down route compensates the secured creditor with the present value of his collateral, the cure route reinstates the initial agreement which is the basis of the claim regardless of the value of the collateral.

Id. at 1154. *See also In re Scott*, 121 B.R. 605, 608 (Bankr. E.D. Okla. 1990) ("If a debtor desires to extend a creditor's payment beyond the term of the Plan, the only avenue available is to cure any default due under the Plan and resume the payments under

the original mortgage. This does not incorporate the use of § 1322(b)(2) in any fashion."); *In re Foster*, 61 B.R. 492, 494 (Bankr. N.D. Ind. 1986) ("absent the cure situation addressed by § 1322(b)(5), no payments beyond the term of the plan can be involuntarily imposed on a creditor"). In short, the debtor can either cram-down the claim and pay the secured portion over the life of the plan or cure the arrears and reinstate the long-term debt according to its original terms.[18]

Thus, cram-down of residential mortgage debt, far from assisting Chapter 13 debtors, would have the effect of accelerating residential mortgages, which are generally long-term obligations, converting them into obligations which must be paid under the plan within five years. This absurd result makes it obvious that Section 1322(b)(2) should not be interpreted to allow cram-down of residential mortgage debt, because such interpretation conflicts with the overall structure of Chapter 13 and thus contravenes the holistic approach to statutory construction mandated by this Court in *Timbers*.

[18] Some courts permitting cram-down have provided debtor a third option, for which there is no basis under the Bankruptcy Code, of cramming down the claim to the value of the collateral and then curing the arrears and allowing the debtor to pay the crammed down value beyond the time limitation imposed by Section 1322(c). *See Sapos*, 967 F.2d at 928; *Bellamy*, 962 F.2d at 185. These courts have created this third option, notwithstanding the absence of any statutory authority for it, to avoid the effect of cram-down under the Bankruptcy Code of requiring debtor to pay the secured claim over the life of the Chapter 13 plan. The fact that courts allowing cram-down have recognized that it only benefits the debtor if further changes are made to the statutory scheme of Chapter 13 illustrates the fallacy of interpreting Section 1322(b)(2) to permit cram-down of residential mortgage claims.

V

CRAM-DOWN COULD HAVE A SEVERE NEGATIVE IMPACT ON CONGRESSIONAL POLICY FAVORING HOME OWNERSHIP

Consideration of Section 1322(b)(2) in light of the consistently expressed policy of Congress to encourage investment in home ownership also mandates the conclusion that cram-down of residential mortgage debt is impermissible under Chapter 13. A steady procession of Congressional enactments beginning in 1934 with the National Housing Act and continuing with the Department of Veterans Affairs Home Loan Guaranty Program, the Housing and Urban Development Act of 1968, the Emergency Home Finance Act of 1970, the Secondary Mortgage Market Enhancement Act of 1984 and the Tax Reform Act of 1986 evidence this clear Congressional policy favoring home ownership. To allow Chapter 13 debtors to cram-down their residential mortgage lenders will undermine this policy.[19]

Cram-down reduces the protection available to lenders through government home mortgage guaranty programs, for lenders who have been crammed down may look to the guarantor only for the reduced balance of the loan. Lenders will thus be required, in order to protect themselves, to seek larger down payments on home loans, especially in geographic areas of economic uncertainty, with the result that the policy of home mortgage guaranty programs — to make mortgages available even to those individuals who cannot afford a substantial down payment — will be frustrated.

Cram-down of residential mortgage debt will also have a negative impact on the secondary mortgage market, in which

[19] The suggestion by Amicus Curiae Harold J. Barkley, Jr. that cram-down only is an issue where junior liens exist on a property is belied by the very facts of this case and the countless other bankruptcy court, district court and circuit court cases in which no junior lien exists. The large number of such cases clearly illustrates that this issue is not limited to factual situations involving junior liens.

entities such as Freddie Mac purchase home mortgage loans and resell those mortgages to investors in the form of mortgage pass-through securities which represent interests in groups of mortgages. The secondary mortgage market has been an important means of increasing the supply, and reducing the costs, of home mortgage credit, and the smooth functioning of this market depends upon a predictable flow of principal and interest from home mortgages. If cram-down is permitted, and borrowers are allowed unilaterally to reduce the balance of their mortgage loans, this predictability will be undermined, and the ability of entities operating in the secondary mortgage market to continue to supply low-cost and plentiful credit to America's homeowners may be adversely affected.

In short, Congress has enacted pervasive and important legislative programs to foster home mortgages and home ownership in America. Congress recognized the potential harmful impact on these programs if cram-down of home loans was allowed, and it provided special protection for home mortgages in the Bankruptcy Code. The only interpretation of Section 1322(b)(2) consistent with this Congressional policy is that adopted by the Fifth Circuit – that a Chapter 13 debtor may not cram-down the claim of a residential mortgage lender.

CONCLUSION

For all the foregoing reasons, as well as those set forth in the Brief of Respondent, the decision of the United States Court of Appeals for the Fifth Circuit should be affirmed.

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